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Legal Update
January 24, 2019

Into the Void (Again): PG&E Intends to Enter Bankruptcy Proceedings – Possible Consequences for Renewable PPAs

After months of speculation, it is now official[1]: PG&E (both the parent, PG&E Corporation, and its subsidiary, Pacific Gas & Electric Company), having faced extraordinary challenges relating to catastrophic wildfires in 2017 and 2018, has announced that a voluntary bankruptcy filing "is appropriate, necessary and in the best interests of all stakeholders, including wildfire claimants, PG&E's other creditors and shareholders, and is ultimately the only viable option to restore PG&E's financial stability to fund ongoing operations and provide safe service to customers." As a result, PG&E expects to file for reorganization under Chapter 11 of the US Bankruptcy Code on or about January 29, 2019, making this PG&E's second bankruptcy in as many decades and, just like the first, the largest US utility bankruptcy at that time.

PG&E's recent 8-K filing provides details of the claims that may result from these fires (which are reported to possibly exceed $30 billion—more than PG&E's current market capitalization—and significantly exceeding available insurance) and the related regulatory proceeding before the California Public Utility Commission (CPUC) as well as the proceedings before Judge William Alsup, who currently oversees the utility subsidiary's probation following the January 26, 2017 guilty finding on six felony counts for the San Bruno explosion.

PG&E states that, having considered "all possible solutions that improve safety and service, while providing equitable treatment for wildfire claimants, employees, customers, other creditors and other constituencies," it has determined that "the Chapter 11 reorganization cases will allow it to work with these many constituencies in one court-supervised forum to comprehensively address its potential liabilities and to implement necessary changes."

PG&E noted that "the decision to seek relief under Chapter 11 will raise concerns among its constituencies, including customers, vendors, suppliers and employees, and may lead to a contraction in trade credit and the departure of key employees." PG&E stated that it has taken steps to mitigate the impact of these potential developments—although without specifically identifying those steps.

Stakeholders with significant concerns include the counterparties to a substantial number of mandated renewable energy power purchase agreements (PPAs) that PG&E solicited and signed under specific statutory and CPUC requirements. Debtors have often sought to reject PPAs in bankruptcy to the extent that the PPAs require the purchase of electricity at rates higher than prevailing market rates.

Bankruptcy law allows for a debtor's rejection of executory contracts[2] subject to court approval. Typically, courts will defer to the debtor's decision to reject an executory contract as long as the debtor has exercised sound business judgment, which may take into account, among other things, the debtor's increased ability to

reorganize as a result of the contract rejection and disaffirmance of continuing performance obligations. The Supreme Court has held that "the authority to reject an executory contract is vital to the basic purpose [of] a Chapter 11 reorganization."[3]

However, rejection of PPAs raises other issues because the Federal Power Act grants the Federal Energy Regulatory Commission (FERC) exclusive jurisdiction over the prices, terms and conditions for the transmission or sale at wholesale of electric energy, including PPAs. The Supreme Court, in a series of cases, established what is now known as the "*Mobile-Sierra* doctrine," which prohibits FERC from setting aside rates previously agreed to by the parties and filed with FERC unless the rate "seriously harm[s] the public interest."[4] Furthermore, under the "filed rate" doctrine, federal courts have found that once a wholesale power contract is filed with FERC, it becomes the equivalent of a federal regulation, and the duty to perform under those contracts not only comes from the agreement itself but also from FERC.[5]

While rejecting PPAs that are no longer necessary or economic may be beneficial to PG&E and its estate[6], this rejection raises at least two critical legal issues. First, does the bankruptcy court have jurisdiction to order rejection of these contracts, or is FERC's approval required to abrogate? Second, what standard of review should be used in deciding whether or not the utility must continue to perform under these contracts? These questions have at least tangentially been addressed in the Second,[7] Fifth[8] and Sixth[9] circuits and, in the Sixth circuit, is subject to pending appeal.

Who has the proper jurisdiction to address PPAs?

In *Mirant*, the district court found rejection of a PPA to be an attack on FERC's rate-making power. The Fifth Circuit reversed, stating "the power of the district court to authorize rejection of the [PPA] does not conflict with the authority given to FERC to regulate rates."[10] They noted where rejection of a PPA was sought because the rate was unfavorable to the debtor, the decision falls within FERC's jurisdiction. However, where the reason for rejecting the agreement is something other than unfavorable rates—such as if the electricity purchased under the agreement represents excess electricity that will no longer be needed after the reorganization, as was the case in *Mirant*—then the district court (or the bankruptcy court as an adjunct of the district court) may have the requisite jurisdiction and authority to authorize rejection.

The district court in *Calpine* reached a slightly different conclusion in finding that the court lacked jurisdiction over the disposition of the PPAs at issue. *Calpine* differed from *Mirant* in that the debtor was seeking to reject PPAs under which they were obligated to sell electricity. The agreements required Calpine to sell electricity at prices much lower than the going market rate, but the debtor was ready and willing to supply the same amount of power at market rates after the contract was rejected. The court noted that under the *Mirant* holding the district court would not be the proper venue because the sole reason for rejecting the contract was the unfavorable rate. But the court went on to hold that FERC's jurisdiction extended beyond rates to terms and conditions of wholesale power agreements, including term. By the *Calpine* court's reasoning, FERC has authority over the rejection of all PPAs in bankruptcy. The *Calpine* court dismissed the motions to reject the PPAs due to the lack of subject matter jurisdiction.

In the *FirstEnergy* bankruptcy proceedings, the most recent to address these issues, the bankruptcy court rejected *Calpine* and went further than *Mirant*, finding that the court had proper jurisdiction to reject PPAs in almost all situations. The court found that rejection of a contract in bankruptcy is a breach of such contract and not a collateral attack on FERC's rate-making ability. Breach of the PPA results in

damages owed by the breaching party, and FERC's approved rate would be given full effect in the calculation of those damages. Even though it was likely that the contract counterparties would not receive the full amount of damages, and thus would receive an effectively lower contract rate as they would be given the same priority as other general unsecured parties, the court concluded that this does not mean that rejection of the agreement would violate FERC's jurisdiction over rate making. Certain of the *First Energy* bankruptcy court's rulings are currently on appeal to the Sixth Circuit.

What standard for rejecting PPAs applies?

Once a bankruptcy court determines that rejection of a PPA is properly within its jurisdiction, there is still the question of what standard should be applied before the PPA is rejected—the debtor's business judgment standard or the more stringent *Mobile-Sierra* doctrine.

The Fifth Circuit suggested in *Mirant* that, even in cases where rejection of a PPA is within the jurisdiction of the bankruptcy court, a more rigorous standard than the business judgement standard should be applied. This includes balancing the interests of the estate against the public interest, including the potential for any interruption of electricity supply as a result of the rejection of any PPA. The court went on to discuss FERC's involvement in the case to highlight those public interests.

The court in *Calpine* found it unnecessary to take any formal position on which standard would apply, given its threshold determination that the bankruptcy court did not have jurisdiction. The court noted the standard put forth in *Mirant* would require some analysis of the public interest and including FERC as a party would likely require the bankruptcy court to sit in judgment of the agency's conclusions. The court found this to be contrary to established case law and used this to bolster its argument that because the public interest must be considered and FERC is the agency to consider the public's interest, FERC must have jurisdiction over the rejection of power purchase agreements.

The debtor in *FirstEnergy* argued that the correct standard must be a business judgment standard, because the relief being sought is the ability to discontinue performance under the executory contract and to leave the counterparty with a damage claim for breach. If the contract is found to go against the public interest by FERC, the contract is abrogated and neither party has any liability to the other. The debtor was seeking to breach the contract but not ultimately to escape damages liability. The court ultimately agreed that the less stringent business judgment standard was correct as it was only concerned with the debtor's ability to restructure and not with the public's interests.

What does this mean for PG&E?

With uncertainty among the courts regarding which judicial or regulatory entity has jurisdiction to address burdensome PPAs and what legal standard should be applied to any proposed rejection of PPAs in bankruptcy, it is unclear what will happen to PG&E's many renewable energy PPAs. Until some consensus is reached, this will be an important consideration for future renewable energy project sponsors when entering into long-term PPAs with utilities.

In a further complication for PG&E, NextEra recently filed a petition for a declaratory order and complaint requesting that FERC issue an order preventing PG&E from abrogating, amending or rejecting in bankruptcy any of the rates, terms and conditions of its wholesale power purchase agreements subject to FERC's jurisdiction if PG&E files a petition for bankruptcy.[11] NextEra has requested that FERC issue an order by January 25, prior to PG&E's

anticipated bankruptcy filing on or about January 29. NextEra presumably took this step as a preventive measure in case PG&E seeks an injunction against FERC from the bankruptcy court after the initiation of a Chapter 11 proceeding.

In its filed answer[12] to NextEra, PG&E makes three primary arguments: (1) any harm is speculative because PG&E has not yet filed for bankruptcy and has not sought to abrogate any executory contracts; (2) as discussed in the *Mirant* decision by the Fifth Circuit, any abrogation of an executory contract would be the equivalent of a breach of contract that does not interfere with FERC's ratemaking authority; and (3) the NextEra PPAs do not contain a *Mobile-Sierra* clause, and, thus, this case differs from the contracts at issue in *Mirant* and *FirstEnergy*.

PG&E also notes that it is the *purchaser* under the PPAs, and FERC's jurisdiction applies only to *sales* of power at wholesale in interstate commerce and that to extend the FPA to *purchases* would amount to "an unprecedented and significant expansion" of FERC's authority. Furthermore, even if FERC has jurisdiction, PG&E argues that it should not exercise its jurisdiction in this instance because this is a normal commercial dispute (which can be handled by federal district courts) and it does not involve technical issues or broad public policy considerations that require FERC's expertise.

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[1] As indicated in PG&E's January 14, 2019 form 8-K filing, available at: http://investor.pgecorp.com/financials/sec-filings/default.aspx. All quotations are taken from this filing.

[2] 11 U.S.C. §365. Although the Bankruptcy Code does not define what makes a contract "executory," the weight of precedent defines such contracts as ones where each party has material unperformed obligations, such that the failure of either to complete its performance would constitute a material breach excusing the performance of the other.

[3] *N.L.R.B v. Bildisco & Bildisco*, 45 U.S. 513, 528 (1984).

[4] *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). In negotiating a PPA, the parties can decide whether to apply the higher "public interest" standard or the more common "just and reasonable" standard of review.

[5] *See In re Calpine Corporation; California ex rel. Lockyer v. Dynergy, Inc.*, 375 F.3d 831, (9th Cir. 2004); *Pennsylvania Water & Power Comm'n*, 343 U.S. 414 (1952).

[6] This is still unclear since (and as NextEra noted in its FERC petition described below) many of PG&E's PPAs are essentially passed through to its customers in rates for purchased power in accordance with related CPUC orders.

[7] *See In re Calpine Corporation*, 337 B.R. 27 (S.D.N.Y. 2006).

[8] *See In re Mirant Corporation*, 378 F.3d 511 (5th Cir. 2004).

[9] *See FirstEnergy Solutions Corp. v. Federal Energy Regulatory Commission*, No. 18-05021, 2018 WL 2315916 (Bankr. N.D. Ohio May 18, 2018).

[10] *In re Mirant Corporation*.

[11] *NextEra Energy, Inc. and NextEra Energy Partners, L.P. v. Pacific Gas & Electric Company*, Docket No. EL19-35-000 (filed January 18, 2019).

[12] *NextEra Energy, Inc. and NextEra Energy Partners, L.P. v. Pacific Gas & Electric Company*, Docket No. EL19-35-000 (filed January 22, 2019).

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